

**SUMMARY OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM
INVESTMENT COMMITTEE**

HELD ON

**Thursday, April 10, 2008
1:00 p.m.**

The Investment Committee (IC) of the Arizona State Retirement System (ASRS) met at 3300 N. Central Avenue, 14th Floor Conference Room, Phoenix, Arizona 85012. Mr. Lawrence Trachtenberg, Chair of the IC, called the meeting to order at 1:04 p.m., Arizona Time.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Lawrence Trachtenberg, Chair
 Mr. Christopher Harris, Vice-chair
 Mr. Thomas Connelly
 Mr. James McLaughlin

A quorum was present for the purpose of conducting business.

2. Presentation, Discussion, and Appropriate Action Regarding Mellon Capital's Global Tactical Asset Allocation (GTAA) Product

Mr. Lawrence Trachtenberg introduced the topic. Mr. Gary R. Dokes, Chief Investment Officer (CIO), said the GTAA Manager(s) Search Committee reaffirms the recommendation to the Investment Committee for subsequent recommendation to the Board for approval:

- Hire Mellon Capital Management as an ASRS GTAA manager.
- Fund with approximately \$500 million from the BGI GTAA passive portfolio.

At the March 2008 IC meeting, the GTAA Manager Search Committee recommended to the IC the hiring of Mellon Capital and Deutsche Bank as new ASRS GTAA managers. Both managers were approved by the IC for subsequent recommendation to the Board.

Between the IC and Board meetings in March, supplemental Mercer research notes were sent to the ASRS following a scheduled Mercer GTAA product strategy meeting with Mellon Capital Management. Given that the research notes raised some concerns regarding Mellon Capital's limited future research initiatives and the leadership of their new CIO, the ASRS CIO, with the approval of the Director and IC Chair, modified the recommendation to the Board to solely request the approval to hire Deutsche Bank. The CIO informed the Board that a subsequent recommendation to the IC and Board to hire or not hire Mellon Capital would be predicated on further ASRS staff discussions with Mercer and Mellon Capital.

On March 27, 2008, the Director, CIO, IMD staff, and Mercer had a conference call with the Chief Executive Officer (CEO) and new CIO of Mellon Capital. As a result, the consensus was that the new CIO demonstrated potential in terms of generating new research ideas and in

managing organizational issues. Additionally, the ASRS and Mercer concurred that funding the Mellon Capital GTAA mandate over the next six to twelve months should be contingent upon the ASRS' ongoing positive assessment throughout 2008 of Mellon Capital's performance and demonstrated leadership capabilities of the new CIO.

Motion: Mr. Trachtenberg moved that the IC recommend the following to the Board for approval:

- Hire Mellon Capital Management as an ASRS GTAA manager.
- Fund with approximately \$500 million from the BGI GTAA passive portfolio, with no funding to occur beyond \$100 million without review and concurrence of the Asset Class Committee or IC, as appropriate.

Mr. Christopher Harris seconded the motion.

By a vote of 4 in favor, 0 opposed, and 0 absent, the motion was approved.

3. Presentation and Discussion, and Appropriate Action Regarding the Arizona State Retirement System (ASRS) Asset Allocation Policy Schematic (Reformat) - Informational

Mr. Trachtenberg introduced the topic. Mr. Dokes asked Mr. Dan Kapanak, Manager of Investment Strategies, to explain why the Asset Allocation Schematic was reformatted.

Mr. Kapanak explained the Asset Allocation Schematic was developed as part of the 2006 Asset Allocation Study, which was presented to and approved by the Board in October 2006. The purpose of the Schematic was to capture and summarize all relevant asset allocation information on one page. Mr. Kapanak noted the Schematic has been reformatted to reflect the following two revisions.

1) International Equity Small Cap has been removed from the Opportunistic Asset Class.

International Small Cap has been reported in both International Equity and as part of the Opportunistic asset class. The Opportunistic asset class category is generally intended for beta-dominated strategies within other asset classes and includes investment strategies designed to take advantage of tactical investment opportunities, such as market dislocations in the subprime mortgage market. Though International Equity Small Cap is not in our Total Fund benchmark and whose performance attribution is captured as a strategic asset allocation effect, ASRS investments in AXA and DFA are considered more strategic or long-term in nature.

2) The Opportunistic asset classes category has been moved "above the line."

The funding for opportunistic investments (e.g. BlackRock Mortgage Investors Fund from BGI passive Fixed Income) will come from one of the other main asset classes. Furthermore, opportunistic investments will be reported in the opportunistic asset class bucket and not within any other asset class. Therefore, to ensure that all investment categories total to 100%, the Opportunistic asset class category needs to be included "above the line," that is, with the other main investment categories.

4. Presentation, Discussion, and Appropriate Action Regarding International Equity Asset Class Reporting for the Quarter Ending 12/31/07 - Informational

Mr. Trachtenberg introduced the topic. Mr. Dokes summarized the evolution in the ASRS International Equity asset class and the current perspective.

As of December 31, 2006, the total market value of the ASRS International Equity asset class was \$5.0 billion, or approximately 18% of the ASRS total fund. International equity assets are currently managed in six portfolios: five active portfolios and one enhanced passive portfolio. International Equity assets are managed by style: core, growth and value. Twelve percent of the International Equity assets are managed in small-cap mandates.

Mr. Kapanak gave background on why restructuring occurred in 2005. Over the past several years, the ASRS International Equity Asset Class has experienced a few structural modifications which primarily have included a change in the asset class benchmark and the hiring of new international large-cap and small-cap investment managers.

Ms. Sarah Wadsworth, Senior Portfolio Analyst, presented detail on current performance. The ASRS International Equity Asset Class Morgan Stanley Capital International (MSCI) Custom Benchmark (MSCI Europe, Australasia, and Far East (EAFE) Index through 9/30/05 and MSCI All Country World Index (ACWI) ex U.S. thereafter) saw impressive 17.1%, 19.4% and 23.4% annual returns over 1, 3 and 5 year periods, respectively, for period ending December 31, 2007.

While ASRS managers generated strong absolute returns, their relative performance to the benchmark has lagged. Mr. Terry Dennison, Worldwide Partner, Mercer Investment Consulting, Inc., said value outperformed growth from 2000-2007. Discussion ensued among all regarding the ASRS International Asset Class paradigm and potential future initiatives.

5. Presentation, Discussion, and Appropriate Action Regarding the ASRS Investment Management Governance Structure, Decision-Making Processes, and Investment Committee Charter (Part Two)

Mr. Trachtenberg introduced the topic. Mr. Dokes outlined the following proposed recommended ASRS investment-related governance policy changes based upon trustee input to date:

1. Engagement of ASRS Investment Managers/Partners
Recommend that the hiring, retention and termination of ASRS Investment Managers/Partners be made by the Director upon the recommendation of the appropriate committee of the four Asset Class Committees:
 - 1) Private Equity Committee (PEC)
 - 2) Real Estate Committee (REC)
 - 3) Public Equity/Fixed Income Markets Committee (PMC)
 - 4) Opportunistic Investment Committee (OIC)
2. Asset Class Committee Organizational Structure/Composition

Recommend that each Asset Class Committee consist of the following members:

- 1) The Director or CIO (or their designee) who will chair the committee
- 2) ASRS staff(s) responsible for portfolio management
- 3) Up to two Trustees (preferred, but not required)
- 4) A designated consultant(s)

3. Engagement of ASRS Investment Consultants

Recommend that the hiring and termination of Investment Consultants be predicated on the primary scope of work and reporting protocol associated with the primary subject matter for which they are engaged by the ASRS.

4. ASRS Investment Policies & Procedures (P&P) Bifurcation

Recommend that ASRS Investment Policies and Procedures (P&Ps) be segregated into:

- 1) Macro-level Strategic Investment Policies to help govern the ASRS investment strategic vision
- 2) Investment Management Division (IMD) Standard Operating Procedures (SOP) which are task-oriented and created to implement Strategic Investment Policies

Further recommend that the responsibility for the ongoing review and approval of IMD SOPs will be delegated to the Director.

5. Board Governance Handbook Revisions

Recommend that the following revisions be considered for the Board Governance Handbook:

- 1) Revisions to the IC Charter
- 2) Addition of a chapter to explain the purpose, duties and responsibilities, organizational structure/committee composition, and voting protocols of ASRS Asset Class Committees

Discussion ensued among all regarding differences between Macro-level Strategic Investment Policies and IMD SOPs.

Mr. Harris expressed concerns he had regarding checks and balances relating to the hiring and termination of Asset Committee Investment Consultants. Discussion commenced on the topic. Mr. Thomas I. McClory, Assistant Attorney General, noted that the Director could obtain the concurrence of the IC or Asset Class Committee, or the Director could have full decision-making power. The Asset Class Committee is a sub-committee of the Director, not of the IC.

Motion: Mr. Trachtenberg moved that the recommendations in the memorandum of April 3, 2008 be recommended to the Board with one change, that change being the hiring or termination of the primary consultant of each of the Asset Class Committees require the Director obtain the consent of the IC.

1. Engagement of ASRS Investment Managers/Partners

Recommend that the hiring, retention and termination of ASRS Investment Managers/Partners be made by the Director upon the recommendation of the appropriate committee of the four

(4) Asset Class Committees:

- 1) Private Equity Committee (PEC)

- 2) Real Estate Committee (REC)
- 3) Public Equity/Fixed Income Markets Committee (PMC)
- 4) Opportunistic Investment Committee (OIC)

2. Asset Class Committee Organizational Structure/Composition

Recommend that each Asset Class Committee consist of the following members:

- 1) The Director or CIO (or their designee) who will chair the committee
- 2) ASRS staff(s) responsible for portfolio management
- 3) Up to two Trustees (preferred, but not required)
- 4) A designated consultant(s)

3. Engagement of ASRS Investment Consultants

Recommend that the hiring and termination of Investment Consultants be predicated on the primary scope of work and reporting protocol associated with the primary subject matter for which they are engaged by the ASRS.

Mr. Harris seconded the motion.

Motion: Mr. Harris moved that the ASRS Investment P&Ps as written be taken to the Board for ratification. The memorandum stated as follows:

4. ASRS Investment Policies & Procedures (P&P) Bifurcation:

Recommend that ASRS Investment Policies and Procedures (P&Ps) be segregated into:

- 1) Macro-level Strategic Investment Policies to help govern the ASRS investment strategic vision
- 2) Investment Management Division (IMD) Standard Operating Procedures (SOP) which are task-oriented and created to implement Strategic Investment Policies

Further recommend that the responsibility for the ongoing review and approval of IMD SOPs will be delegated to the Director.

Mr. Jim McLaughlin seconded the motion.

By a vote of 4 in favor, 0 opposed, and 0 absent, the motion was approved.

Motion: Mr. Harris moved that the ratification of the Asset Class Committee protocol as outlined in the IC packet be proposed to the Board. The memorandum of April 3, 2008 in the IC packet states:

Board Governance Handbook Revisions

Recommend that the following revisions be considered for the Board Governance Handbook:

- 1) Revisions to the IC Charter
- 2) Addition of a chapter to explain the purpose, duties and responsibilities, organizational structure/committee composition, and voting protocols of ASRS Asset Class Committees

Mr. Trachtenberg seconded the motion.

By a vote of 4 in favor, 0 opposed, and 0 absent, the motion was approved.

6. Call to the Public

No members of the public requested to speak to the IC.

The meeting adjourned at 3:56 PM.

Respectfully submitted,

Lisa Hanneman, Secretary

Date

Gary R. Dokes, Chief Investment Officer Date